

**MUNICIPALITY OF SPENCER
SPENCER, SOUTH DAKOTA**

AUDIT REPORT

FOR THE YEAR JANUARY 1, 2005 TO DECEMBER 31, 2005

Schoenfish & Co., Inc.

CERTIFIED PUBLIC ACCOUNTANTS

P.O. Box 247

105 EAST MAIN, PARKSTON, SOUTH DAKOTA 57366

MUNICIPALITY OF SPENCER

MUNICIPAL OFFICIALS
DECEMBER 31, 2005

GOVERNING BOARD:

Donna Ruden - President
Beverly Heidelberger
Arnold Scheuren

FINANCE OFFICER:

Jason Troxell

ATTORNEY:

Michael Unke

Schoenfish & Co., Inc.

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Municipal Council
Municipality of Spencer
Spencer, South Dakota

We have audited the financial statements of the governmental activities, business-type activities, and each major fund of the Municipality of Spencer, South Dakota, as of December 31, 2005, and for the year then ended and have issued our report thereon dated July 21, 2006, which was qualified because of improper reporting of interest income. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Municipality of Spencer's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Municipality of Spencer's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of current audit findings as item 2005-01. We also noted certain additional matters involving the internal control over financial reporting that we have reported to the management of the Municipality of Spencer in a separate communication dated July 21, 2006.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable condition described above, we consider item 2005-01 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality of Spencer's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and other matters, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

We noted certain additional matters involving compliance and other matters that we have reported to the management of the Municipality of Spencer in a separate communication dated July 21, 2006.

This report is intended solely for the information and use of the South Dakota Legislature, state granting agencies, and the governing board and management of the Municipality of Spencer and is not intended to be and should not be used by anyone other than these specified parties. However, as required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.



Schoenfish & Co., Inc.
Certified Public Accountants
July 21, 2006

Schoenfish & Co., Inc.

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SCHEDULE OF PRIOR AUDIT FINDINGS

PRIOR AUDIT FINDINGS:

Finding Number 2001-01:

A reportable condition and material weakness in internal controls was noted due to a lack of proper segregation of duties for revenues. The prior audit comment has not been corrected and is restated under current audit findings as finding number 2005-01.

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SCHEDULE OF CURRENT AUDIT FINDINGSCURRENT OTHER AUDIT FINDINGS:Internal Control Over RevenuesFinding Number 2005-01:

A reportable condition and material weakness in internal controls was noted due to a lack of proper segregation of duties for revenues. This is the sixth consecutive audit in which a similar comment has occurred.

Criteria:

Proper segregation of duties results in increased reliability of reported financial data and decreased potential for the loss of public assets.

Condition:

The Finance Officer processes all revenue transactions from beginning to end. The Finance Officer also receives money, issues receipts, records receipts, posts receipts in the accounting records, prepares bank deposits, reconciles bank statements, and prepares financial statements.

Effect:

As a result, there is an increased likelihood that errors could occur and not be detected in a timely manner by employees in the ordinary course of performing their duties.

Recommendation:

1. We recommend that the Municipality of Spencer officials be cognizant of this lack of segregation of duties for revenues and attempt to provide compensating internal controls whenever, and wherever possible and practical.

Corrective Action Plan:

The Municipality of Spencer President, Donna Ruden, is the contact person responsible for the corrective action plan for this comment. This comment is due to the size of the Municipality of Spencer, which precludes staffing at a level sufficient to provide an ideal environment for internal controls. We are aware of this problem and are attempting to provide compensating controls.

CLOSING CONFERENCE

The audit findings and recommendations were discussed with the officials during the course of the audit and with the board president, board members and the finance officer on August 14, 2006.

Schoenfish & Co., Inc.

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INDEPENDENT AUDITOR'S REPORT

Municipal Council
Municipality of Spencer
Spencer, South Dakota

We have audited the accompanying financial statements of the governmental activities, the business-type activities, and each major fund of the Municipality of Spencer, South Dakota, as of and for the year ended December 31, 2005, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality of Spencer's management. Our responsibility is to express opinions on these financial statements based on our audit.

Except as discussed in the third paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are the Municipality's internal control over financial reporting. Accordingly, we do not express such an opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

Interest income for funds other than the General Fund was not recognized in the fund reporting the investment. As required by GAAP, this income should be reported in each respective fund and subsequently transferred to the General Fund per municipal policy. The amounts of this subject are not reasonably determinable.

As discussed in Note 1.c., the Municipality of Spencer, South Dakota, prepares its financial statements on modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, except for the effects, if any, of not reporting interest income in the fund where the investment is reported, the financial statements referred to above present fairly, in all material respects, the respective financial position, modified cash basis, of the governmental activities, the business-type activities, and each major fund of the Municipality of Spencer as of December 31, 2005, and the respective changes in financial position and cash flows, modified cash basis, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America with the basis of accounting described in note 1.c.

In accordance with Government Auditing Standards, we have also issued our report dated July 21, 2006, on our consideration of the Municipality of Spencer's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal

control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The budgetary comparison schedules on pages 23 through 25 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it. The City of Spencer has not presented Management's Discussion & Analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.



Schoenfish & Co., Inc.
Certified Public Accountants
July 21, 2006

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MUNICIPALITY OF SPENCER
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS
December 31, 2005

	Primary Government	
	Governmental	Business-Type
	Activities	Activities
		Total
ASSETS:		
Cash and Cash Equivalents	30,868.73	32,690.79
Investments	340,000.00	35,000.00
Restricted Assets:		
Cash and Cash Equivalents		3,087.00
TOTAL ASSETS	370,868.73	70,777.79
LIABILITIES:		
Other Current Liabilities		3,087.00
Total Liabilities	0.00	3,087.00
NET ASSETS:		
Restricted:		
Capital Improvements	43,850.49	43,850.49
Unrestricted	327,018.24	67,690.79
Total Net Assets	370,868.73	67,690.79
TOTAL LIABILITIES & NET ASSETS	370,868.73	70,777.79

The notes to the financial statements are an integral part of this statement.

MUNICIPALITY OF SPENCER
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS
For the Year Ended December 31, 2005

Functions/Programs	Program Revenues				Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government		Total
					Governmental Activities	Business-Type Activities	
Primary Government:							
Governmental Activities:							
General Government	31,323.35	6,292.25			(25,031.10)		(25,031.10)
Public Safety	658.96	50.00			(608.96)		(608.96)
Public Works	38,516.23		11,342.03	1,050.00	(26,124.20)		(26,124.20)
Culture and Recreation	5,030.35				(5,030.35)		(5,030.35)
Conservation and Development	396.76				(396.76)		(396.76)
Total Governmental Activities	75,925.65	6,342.25	11,342.03	1,050.00	(57,191.37)	0.00	(57,191.37)
Business-type Activities:							
Water	15,985.45	19,355.96				3,370.51	3,370.51
Sewer	300.50	9,487.50				9,187.00	9,187.00
Solid Waste	8,562.59	8,708.96				146.37	146.37
Total Business-Type Activities	24,848.54	37,552.42	0.00	0.00		12,703.88	12,703.88
Total Primary Government	100,774.19	43,894.67	11,342.03	1,050.00	(57,191.37)	12,703.88	(44,487.49)
General Revenues:							
Taxes:							
Property Taxes					50,975.77		50,975.77
Sales Taxes					15,197.11		15,197.11
State Shared Revenues					990.98		990.98
Unrestricted Investment Earnings					7,462.05		7,462.05
Miscellaneous Revenue					7,176.71		7,176.71
Total General Revenues and Transfers					81,802.62	0.00	81,802.62
Change in Net Assets					24,611.25	12,703.88	37,315.13
Net Assets-Beginning					346,257.48	54,986.91	401,244.39
NET ASSETS-ENDING					370,868.73	67,690.79	438,559.52

The notes to the financial statements are an integral part of this statement.

**MUNICIPALITY OF SPENCER
BALANCE SHEET - MODIFIED CASH BASIS
GOVERNMENTAL FUNDS
December 31, 2005**

	<u>General Fund</u>	<u>Second Penny Sales Tax Fund</u>	<u>Disaster Relief Fund</u>	<u>Welcome to Spencer Fund</u>	<u>Total Governmental Funds</u>
ASSETS:					
Cash and Cash Equivalents	13,756.81	3,850.49	13,056.79	204.64	30,868.73
Investments	<u>250,000.00</u>	<u>40,000.00</u>	<u>50,000.00</u>		<u>340,000.00</u>
TOTAL ASSETS	<u>263,756.81</u>	<u>43,850.49</u>	<u>63,056.79</u>	<u>204.64</u>	<u>370,868.73</u>
FUND BALANCES:					
Unreserved Fund Balances:					
Designated for Next Year's Budget	37,756.23				37,756.23
Undesignated	<u>226,000.58</u>	<u>43,850.49</u>	<u>63,056.79</u>	<u>204.64</u>	<u>333,112.50</u>
TOTAL FUND BALANCES	<u>263,756.81</u>	<u>43,850.49</u>	<u>63,056.79</u>	<u>204.64</u>	<u>370,868.73</u>

The notes to the financial statements are an integral part of this statement.

MUNICIPALITY OF SPENCER
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES - MODIFIED CASH BASIS
GOVERNMENTAL FUNDS
For the Year Ended December 31, 2005

	General Fund	Second Penny Sales Tax Fund	Disaster Relief Fund	Welcome to Spencer Fund	Total Governmental Funds
Revenues:					
Taxes:					
General Property Taxes	50,322.64				50,322.64
General Sales and Use Taxes	15,197.11				15,197.11
Tax Deed Revenue	43.03				43.03
Penalties & Interest on Delinquent Taxes	610.10				610.10
Total Taxes	66,172.88	0.00	0.00	0.00	66,172.88
Licenses and Permits	392.93				392.93
Intergovernmental Revenue:					
State Grants	250.00				250.00
State Shared Revenue:					
Bank Franchise Tax	177.81				177.81
Liquor Tax Reversion	813.17				813.17
Motor Vehicle Licenses	3,464.93				3,464.93
Local Government Highway and Bridge Fund	4,205.24				4,205.24
County Shared Revenue:					
County Road Tax	326.19				326.19
County HBR Tax	1,313.35				1,313.35
County Wheel Tax	1,782.32				1,782.32
Total Intergovernmental Revenue	12,333.01	0.00	0.00	0.00	12,333.01
Charges for Goods and Services:					
General Government	5,899.32	0.00	0.00	0.00	5,899.32
Fines and Forfeits:					
Court Fines and Costs	50.00	0.00	0.00	0.00	50.00
Miscellaneous Revenue:					
Investment Earnings	7,462.05				7,462.05
Rentals	4,400.00				4,400.00
Special Assessments	1,050.00				1,050.00
Other	1,960.71				1,960.71
Total Miscellaneous Revenue	14,872.76	0.00	0.00	0.00	14,872.76
Total Revenue	99,720.90	0.00	0.00	0.00	99,720.90

The notes to the financial statements are an integral part of this statement.

MUNICIPALITY OF SPENCER
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES - MODIFIED CASH BASIS
GOVERNMENTAL FUNDS
For the Year Ended December 31, 2005

	General Fund	Second Penny Sales Tax Fund	Disaster Relief Fund	Welcome to Spencer Fund	Total Governmental Funds
Expenditures:					
General Government:					
Legislative	5,683.14				5,683.14
Financial Administration	7,229.29				7,229.29
Other	18,410.92				18,410.92
Total General Government	31,323.35	0.00	0.00	0.00	31,323.35
Public Safety:					
Fire	658.96				658.96
Total Public Safety	658.96	0.00	0.00	0.00	658.96
Public Works:					
Highways and Streets	38,516.23				38,516.23
Total Public Works	38,516.23	0.00	0.00	0.00	38,516.23
Culture and Recreation:					
Parks	5,030.35				5,030.35
Total Culture and Recreation	5,030.35	0.00	0.00	0.00	5,030.35
Conservation and Development:					
Economic Development and Assistance (Industrial Development)				396.76	396.76
Total Conservation and Development	0.00	0.00	0.00	396.76	396.76
Total Expenditures	75,528.89	0.00	0.00	396.76	75,925.65
Excess Revenue Over (Under) Expenditures	24,192.01	0.00	0.00	(396.76)	23,795.25
Other Financing Sources (Uses):					
Compensation for Loss or Damage to Capital Assets	816.00				816.00
Net Change in Fund Balance	25,008.01	0.00	0.00	(396.76)	24,611.25
Fund Balance - Beginning	238,748.80	43,850.49	63,056.79	601.40	346,257.48
FUND BALANCE- ENDING	263,756.81	43,850.49	63,056.79	204.64	370,868.73

The notes to the financial statements are an integral part of this statement.

MUNICIPALITY OF SPENCER
BALANCE SHEET - MODIFIED CASH BASIS
PROPRIETARY FUNDS
December 31, 2005

	Enterprise Funds			
	Water Fund	Sewer Fund	Solid Waste Fund	Totals
ASSETS:				
Current Assets:				
Cash and Cash Equivalents	7,514.57	13,919.89	11,256.33	32,690.79
Investments	15,000.00	20,000.00		35,000.00
Total Current Assets	22,514.57	33,919.89	11,256.33	67,690.79
Noncurrent Assets:				
Restricted Cash and Cash Equivalents	3,087.00			3,087.00
Total Noncurrent Assets	3,087.00	0.00	0.00	3,087.00
TOTAL ASSETS	25,601.57	33,919.89	11,256.33	70,777.79
LIABILITIES:				
Water Deposits	3,087.00			3,087.00
Total Liabilities	3,087.00	0.00	0.00	3,087.00
NET ASSETS:				
Unrestricted Net Assets	22,514.57	33,919.89	11,256.33	67,690.79
Total Net Assets	22,514.57	33,919.89	11,256.33	67,690.79
TOTAL LIABILITIES AND NET ASSETS	25,601.57	33,919.89	11,256.33	70,777.79

The notes to the financial statements are an integral part of this statement.

MUNICIPALITY OF SPENCER
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN
FUND NET ASSETS - MODIFIED CASH BASIS
PROPRIETARY FUNDS
For the Year Ended December 31, 2005

	Enterprise Funds			
	Water Fund	Sewer Fund	Solid Waste Fund	Totals
Operating Revenue:				
Charges for Goods and Services	19,355.96	9,487.50	8,708.96	37,552.42
Total Operating Revenue	19,355.96	9,487.50	8,708.96	37,552.42
Operating Expenses:				
Other Current Expense	15,985.45	300.50	8,562.59	24,848.54
Total Operating Expenses	15,985.45	300.50	8,562.59	24,848.54
Operating Income (Loss)	3,370.51	9,187.00	146.37	12,703.88
Change in Net Assets	3,370.51	9,187.00	146.37	12,703.88
Net Assets-Beginning	19,144.06	24,732.89	11,109.96	54,986.91
Net Assets-Ending	22,514.57	33,919.89	11,256.33	67,690.79

The notes to the financial statements are an integral part of this statement.

MUNICIPALITY OF SPENCER
STATEMENT OF CASH FLOWS - MODIFIED CASH BASIS
PROPRIETARY FUNDS
For the Year Ended December 31, 2005

	Enterprise Funds			
	Water Fund	Sewer Fund	Solid Waste Fund	Totals
CASH FLOWS FROM OPERATING ACTIVITIES:				
Receipt from Customers	19,355.96	9,487.50	8,708.96	37,552.42
Payments to Suppliers	(15,985.45)	(300.50)	(8,562.59)	(24,848.54)
Net Cash Provided (Used) by Operating Activities	3,370.51	9,187.00	146.37	12,703.88
Net Increase (Decrease) in Cash and Cash Equivalents	3,370.51	9,187.00	146.37	12,703.88
Cash and Cash Equivalents - Beginning	22,231.06	24,732.89	11,109.96	58,073.91
Cash and Cash Equivalents - Ending	25,601.57	33,919.89	11,256.33	70,777.79
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:				
Operating Income (Loss)	3,370.51	9,187.00	146.37	12,703.88

The notes to the financial statements are an integral part of this statement.

NOTES TO THE MODIFIED CASH BASIS FINANCIAL STATEMENTS1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As discussed further in Note 1.c, these financial statements are presented on a modified cash basis of accounting. The modified cash basis of accounting differs from accounting principles generally accepted in the United States of America (GAAP). Generally accepted accounting principles include all relevant Governmental Accounting Standards Board (GASB) pronouncements. In the government-wide financial statements and the fund financial statements for proprietary funds, Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, have not been applied, to the extent they are applicable to the modified cash basis of accounting, unless those pronouncements conflict with or contradict GASB pronouncements, in which case GASB prevails.

a. Financial Reporting Entity:

The reporting entity of the Municipality of Spencer consists of the primary government (which includes all of the funds, organizations, institutions, agencies, departments, and offices that make up the legal entity, plus those funds for which the primary government has a fiduciary responsibility, even though those fiduciary funds may represent organizations that do not meet the criteria for inclusion in the financial reporting entity); those organizations for which the primary government is financially accountable; and other organizations for which the nature and significance of their relationship with the primary government are such that their exclusion would cause the financial reporting entity's financial statements to be misleading or incomplete.

b. Basis of Presentation:

Government-wide Financial Statements:

The Statement of Net Assets and Statement of Activities display information about the reporting entity as a whole. They include all funds of the reporting entity except for fiduciary funds. The statements distinguish between governmental and business-type activities and discretely presented component units. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

The statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the Municipality and for each function of the Municipality's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by recipients of goods and services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements:

Fund financial statements of the reporting entity are organized into funds, each of which is considered to be a separate accounting entity. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, fund equity, revenues, and expenditures/expenses. Funds are organized into three major categories: governmental, proprietary, and fiduciary. An emphasis is placed on major funds within the governmental and proprietary categories. A fund is considered major if it is the primary operating fund of the Municipality or it meets the following criteria.

Schoenfish & Co., Inc.

CERTIFIED PUBLIC ACCOUNTANTS

P.O. Box 247

105 EAST MAIN, PARKSTON, SOUTH DAKOTA 57366

NOTES TO THE MODIFIED CASH BASIS FINANCIAL STATEMENTS
(Continued)

1. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental or enterprise fund are at least 10 percent of the corresponding total for all funds of that category or type, and
2. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined, or
3. Management has elected to classify one or more governmental or enterprise funds as major for consistency in reporting from year to year, or because of public interest in the fund's operations.

The funds of the Municipality financial reporting entity are described below:

Governmental Funds:

General Fund - the General Fund is the general operating fund of the Municipality. It is used to account for all financial resources except those required to be accounted for in another fund. The General Fund is always a major fund.

Special Revenue Funds - special revenue funds are used to account for the proceeds of special revenue sources (other than trusts for individuals, private organizations, or other governments or for major capital projects) that are legally restricted to expenditures for specified purposes.

Additional Sales Tax Fund - to account for an additional one percent sales tax which may be used only for capital improvement, land acquisition, the funding of public ambulances and medical emergency response vehicles, public hospitals, or nonprofit hospitals with fifty or fewer licensed beds and other public health care facilities or nonprofit health care facilities with fifty or fewer licensed beds, the transfer to the special 911 fund, the purchasing of fire fighting vehicles and equipment, and debt retirement. (SDCL 10-52-2) This is a major fund.

Disaster Relief Fund - to account for any gifts received as a result of the tornado of 1998 for the purpose of rebuilding the town. This is a major fund.

Welcome to Spencer Fund - to account for any gifts received for the promotion of the town. This is a major fund.

Proprietary Funds:

Enterprise Funds - enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues, earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The enterprise funds do not apply any FASB Statements and Interpretations issued after November 30, 1989.

Water Fund - financed primarily by user charges, this fund accounts for the construction and operation of the municipal waterworks system and related facilities. (SDCL 9-47-1) This is a major fund.

Sewer Fund - financed primarily by user charges, this fund accounts for the construction and operation of the municipal sanitary sewer system and related facilities. (SDCL 9-48-2) This is a major fund.

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NOTES TO THE MODIFIED CASH BASIS FINANCIAL STATEMENTS
(Continued)

Solid Waste Fund – financed primarily by user charges, this fund accounts for the collection and disposal of solid waste from the municipality. (SDCL 9-32-11 and 34A-6) This is a major fund.

c. Measurement Focus and Basis of Accounting:

Measurement focus is a term used to describe "how" transactions are recorded within the various financial statements. Basis of accounting refers to "when" revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus.

During 2005, The Municipality used the modified cash basis, which is a basis of accounting other than USGAAP. Under USGAAP, transactions are recorded in the accounts when revenues are earned and liabilities are incurred. Under the modified cash basis, transactions are recorded when cash is received or disbursed.

Measurement Focus:

In the government-wide Statement of Net Assets and Statement of Activities, both governmental and business-type activities are presented using the economic resources measurement focus, applied within the limitations of the modified cash basis of accounting as defined below.

In the fund financial statements, the "current financial resources" measurement focus or the "economic resources" measurement focus is used, applied with the limitations of the modified cash basis of accounting.

Basis of Accounting:

In the Government-wide Statement of Net Assets and Statement of Activities and the fund financial statements, governmental and business-type activities are presented using a modified cash basis of accounting.

The modified cash basis of accounting involves the measurement of cash and cash equivalents and changes in cash and cash equivalents resulting from cash receipt and disbursement transactions. Under the modified cash basis of accounting, transactions are recorded in the accounts when cash and/or cash equivalents are received or disbursed and assets and liabilities are recognized to the extent that cash has been received or disbursed. Acceptable modifications to the cash basis of accounting implemented by the Municipality in these financial statements are:

- a. Recording long-term investments in marketable securities (those with maturities more than 90-days (three months) from the date of acquisition) acquired with cash assets at cost.

As a result of the use of this modified cash basis of accounting, certain assets and their related revenues (such as accounts receivable and revenue for billed or provided services not yet collected) and certain liabilities and their related expenses (such as accounts payable and expenses for goods or services received but not yet paid, and accrued expenses and liabilities) are not recorded in these financial statements.

If the Municipality applied USGAAP, the fund financial statements for governmental funds would use the modified accrual basis of accounting, while the fund financial statements for proprietary fund types would use the accrual basis of accounting. All government-wide financial statements would be presented on the accrual basis of accounting.

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NOTES TO THE MODIFIED CASH BASIS FINANCIAL STATEMENTS
(Continued)

d. Deposits and Investments:

For the purpose of financial reporting, "cash and cash equivalents" includes all demand and savings accounts and certificates of deposit or short-term investments with a term to maturity at date of acquisition of three months or less. Investments in open-end mutual fund shares, or similar investments in external investment pools, are also considered to be cash equivalents.

Investments classified in the financial statements consist of certificates of deposit whose term to maturity at date of acquisition exceeds three months, and/or those types of investment authorized by South Dakota Codified Laws (SDCL) 4-5-6. Under the modified cash basis of accounting, investments are carried at cost.

e. Interfund Eliminations and Reclassifications:

Government-wide Financial Statements:

In the process of aggregating data for the government-wide financial statements, some amounts reported as interfund activity and balances in the fund financial statements have been eliminated or reclassified, as follows:

1. In order to minimize the grossing-up effect on assets and liabilities within the governmental and business-type activities columns of the primary government, amounts reported as interfund receivables and payables have been eliminated in the governmental and business-type activities columns, except for the net, residual amounts due between governmental and business-type activities, which are presented as Internal Balances. The Municipality did not have interfund receivables and payables which required elimination as of December 31, 2005.
2. In order to minimize the doubling-up effect on internal service fund activity, certain "centralized expenses" including an administrative overhead component, are charged as direct expenses to funds or programs in order to show all expenses that are associated with a service, program, department, or fund. The Municipality did not have internal service fund activity which required elimination as of December 31, 2005.

Fund Financial Statements:

Noncurrent portions of long-term interfund receivables (reported in "Advance to" asset accounts) are equally offset by a fund balance reserve account which indicates that they do not constitute "available spendable resources" since they are not a component of net current assets. Current portions of interfund receivables (reported in "Due from" asset accounts) are considered "available spendable resources."

f. Revenue Received in Advance:

Under the modified cash basis of accounting, cash may have been received in advance of the Municipality's providing a good or service to a customer. These amounts are reported in the financial statements, as applicable.

g. Program Revenues:

Program revenues derive directly from the program itself or from parties other than the Municipality's taxpayers or citizenry, as a whole. Program revenues are classified into three categories, as follows:

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(Continued)

1. Charges for services - These arise from charges to customers, applicants, or others who purchase, use, or directly benefit from the goods, services, or privileges provided, or are otherwise directly affected by the services.
2. Program-specific operating grants and contributions - These arise from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program.
3. Program-specific capital grants and contributions - These arise from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for the acquisition of capital assets for use in a particular program.

h. Proprietary Funds Revenue and Expense Classifications:

In the proprietary fund's Statement of Revenues, Expenses and Changes in Fund Net Assets, revenues and expenses are classified in a manner consistent with how they are classified in the Statement of Cash Flows. That is, transactions for which related cash flows are reported as capital and related financing activities, noncapital financing activities, or investing activities are not reported as components of operating revenues and expenses.

i. Cash and Cash Equivalents:

The Municipality pools the cash resources of its funds for cash management purposes. The proprietary funds essentially have access to the entire amount of their cash resources on demand. Accordingly, each proprietary fund's equity in the cash management pool is considered to be cash and cash equivalents for the purpose of the Statement of Cash Flows.

j. Equity Classifications:

Government-wide Statements:

Equity is classified as net assets and is displayed in three components.

1. Invested in capital assets arising from cash transactions, net of related debt - Consists of capital assets, including restricted capital assets, net of accumulated depreciation (if applicable) and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
2. Restricted net assets - Consists of net assets with constraints placed on their use either by (a) external groups such as creditors, grantors, contributors, or laws and regulations of other governments; or (b) law through constitutional provisions or enabling legislation.
3. Unrestricted net assets - All other net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

Fund Financial Statements:

Governmental fund equity is classified as fund balance, and may distinguish between "Reserved" and "Unreserved" components. Proprietary fund equity is classified the same as in the government-wide financial statements.

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NOTES TO THE MODIFIED CASH BASIS FINANCIAL STATEMENTS
(Continued)

k. Application of Net Assets:

It is the Municipality's policy to first use restricted net assets, prior to the use of unrestricted net assets, when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

2. VIOLATIONS OF FINANCE-RELATED LEGAL AND CONTRACTUAL PROVISIONS:

The Municipality is prohibited by statute from spending in excess of appropriated amounts at the department level. The following represents the significant overdrafts of the expenditures compared to appropriations:

	Year Ended <u>12/31/2005</u>
General Fund:	
Legislative	\$ 2,138.14
Parks	\$ 195.35
Wellcome to Spencer Fund:	
Economic Development and Assistance	\$ 396.76

The Municipality plans to take the following actions to address these violations: contingency transfers and supplemental budgets will be used.

3. DEPOSITS AND INVESTMENTS, CREDIT RISK, CONCENTRATIONS OF CREDIT RISK AND INTEREST RATE RISK

The Municipality follows the practice of aggregating the cash assets of various funds to maximize cash management efficiency and returns. Various restrictions on deposits and investments are imposed by statutes. These restrictions are summarized below:

Deposits - The Municipality's cash deposits are made in qualified public depositories as defined by SDCL 4-6A-1, 9-22-6, 9-22-6.1 and 9-22-6.2, and may be in the form of demand or time deposits.

Qualified depositories are required by SDCL 4-6A-3 to maintain at all times, segregated from their other assets, eligible collateral having a value equal to at least 100 percent of the public deposit accounts which exceed deposit insurance such as the FDIC and NCUA. In lieu of pledging eligible securities, a qualified public depository may furnish irrevocable standby letters of credit issued by Federal Home Loan Banks accompanied by written evidence of that bank's public debt rating which may not be less than "AA" or a qualified public depository may furnish a corporate surety bond of a corporation authorized to do business in South Dakota.

Deposits are reported at cost plus interest, if the account is of the add-on type.

Investments - In general, SDCL 4-5-6 permits Municipality funds to be invested in (a) securities of the United States and securities guaranteed by the United States government either directly or indirectly including, without limitation, United States treasury bills, notes, and other obligations issued or directly or indirectly guaranteed by the United States government, or otherwise directly or indirectly backed by the full faith and credit of the United States government, provided that, for other than permanent, trust, retirement, building, and depreciation reserve funds, such securities shall either mature within eighteen months from the date of

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purchase or be redeemable at the option of the holder within eighteen months from the date of purchase; or (b) repurchase agreements fully collateralized by securities described in (a) above and meeting the requirements of Section 4-5-9, if the repurchase agreements are entered into only with those primary reporting dealers that report to the Federal Reserve Bank of New York and with the one hundred largest United States commercial banks, as measured by domestic deposits; or (c) in shares of an open-end, no-load fund administered by an investment company registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933 and whose only investments are in securities described in (a) and repurchase agreements described in (b).

Interest Rate Risk – The Municipality does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk – State law limits eligible investments for the Municipality, as discussed above. The Municipality has no investment policy that would further limit its investment choices.

Concentration of Credit Risk – The Municipality places no limit on the amount that may be invested in any one issuer.

Assignment of Investment Income – State law allows income from deposits and investments to be credited to either the General Fund or the fund making the investment. The Municipality's policy is to credit all income from deposits and investments to the General Fund. USGAAP, on the other hand, requires income from deposits and investments to be reported in the fund whose assets generated that income. Where the governing board has resources for investment, a transfer to the designated fund is reported. These interfund transfers are not violations of the statutory restriction on interfund transfers. The Municipality did not record these transfers in 2005.

4. PROPERTY TAXES

Property taxes are levied on or before October 1, of the year preceding the start of the fiscal year. They attach as an enforceable lien on property and become due and payable as of January 1, the first day of the fiscal year. Taxes are payable in two installments on or before April 30 and October 31 of the fiscal year.

The Municipality is permitted by several state statutes to levy varying amounts of taxes per \$1,000 of taxable valuation on taxable property in the Municipality.

5. OPERATING LEASES

The Town of Spencer entered into a forty year operating lease with Hanson Rural Water System to provide water to the town. No monthly service charge is paid by the town to Hanson Rural Water System. The town pays for water based on the current bulk water user rate. The town will not acquire ownership of any of these water facilities through these lease payments. Payments are made from the town's Water Fund.

There are no minimum payments on this operating lease.

6. SIGNIFICANT CONTINGENCIES - LITIGATION

At December 31, 2005, the Municipality was not involved in any litigation.

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7. RISK MANAGEMENT

The Municipality is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During the period ended December 31, 2005, the Municipality managed its risks as follows:

Liability Insurance:

The Municipality purchases liability insurance for risks related to torts; theft or damage to property; and errors and omissions of public officials from a commercial insurance carrier.

Workmen's Compensation:

The Municipality purchases liability insurance for workmen's compensation from a commercial carrier.

Unemployment Benefits:

The Municipality provides coverage for unemployment benefits by paying into the Unemployment Compensation Fund established by state law and managed by the State of South Dakota.

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REQUIRED SUPPLEMENTARY INFORMATION
MUNICIPALITY OF SPENCER
BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
For the Year Ended December 31, 2005

	Budgeted Amounts		Actual Amounts	Variance with
	Original	Final	(Budgetary Basis)	Final Budget - Positive (Negative)
Revenues:				
Taxes:				
General Property Taxes	50,029.00	50,029.00	50,322.64	293.64
General Sales and Use Taxes	10,000.00	10,000.00	15,197.11	5,197.11
Tax Deed Revenue	100.00	100.00	43.03	(56.97)
Penalties & Interest on Delinquent Taxes	500.00	500.00	610.10	110.10
Total Taxes	60,629.00	60,629.00	66,172.88	5,543.88
Licenses and Permits	0.00	0.00	392.93	392.93
Intergovernmental Revenue:				
State Grants	0.00	0.00	250.00	250.00
State Shared Revenue:				
Bank Franchise Tax	400.00	400.00	177.81	(222.19)
Liquor Tax Reversion	400.00	400.00	813.17	413.17
Motor Vehicle Licenses	3,500.00	3,500.00	3,464.93	(35.07)
Local Government Highway and Bridge Fund	2,150.00	2,150.00	4,205.24	2,055.24
County Shared Revenue:				
County Road Tax	1,000.00	1,000.00	326.19	(673.81)
County HBR Tax	2,500.00	2,500.00	1,313.35	(1,186.65)
County Wheel Tax	1,650.00	1,650.00	1,782.32	132.32
Total Intergovernmental Revenue	11,600.00	11,600.00	12,333.01	733.01
Charges for Goods and Services:				
General Government	0.00	0.00	5,899.32	5,899.32
Total Charges for Goods & Services	0.00	0.00	5,899.32	5,899.32
Fines and Forfeits:				
Court Fines and Costs	0.00	0.00	50.00	50.00
Miscellaneous Revenue:				
Investment Earnings	5,000.00	5,000.00	7,462.05	2,462.05
Rentals	4,210.00	4,210.00	4,400.00	190.00
Special Assessments	1,010.00	1,010.00	1,050.00	40.00
Other	0.00	0.00	1,960.71	1,960.71
Total Miscellaneous Revenue	10,220.00	10,220.00	14,872.76	4,652.76
Total Revenue	82,449.00	82,449.00	99,720.90	17,271.90

REQUIRED SUPPLEMENTARY INFORMATION
MUNICIPALITY OF SPENCER
BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
For the Year Ended December 31, 2005

	Budgeted Amounts		Actual Amounts	Variance with
	Original	Final	(Budgetary Basis)	Final Budget - Positive (Negative)
Expenditures:				
General Government:				
Legislative	3,545.00	3,545.00	5,683.14	(2,138.14)
Contingency	4,600.00	4,600.00		
Amount Transferred		0.00		4,600.00
Elections	440.00	440.00	0.00	440.00
Financial Administration	13,542.00	13,542.00	7,229.29	6,312.71
Other	23,065.00	23,065.00	18,410.92	4,654.08
Total General Government	45,192.00	45,192.00	31,323.35	13,868.65
Public Safety:				
Police	6,000.00	6,000.00	0.00	6,000.00
Fire	1,745.00	1,745.00	658.96	1,086.04
Total Public Safety	7,745.00	7,745.00	658.96	7,086.04
Public Works:				
Highways and Streets	49,430.00	49,430.00	38,516.23	10,913.77
Total Public Works	49,430.00	49,430.00	38,516.23	10,913.77
Culture and Recreation:				
Parks	4,835.00	4,835.00	5,030.35	(195.35)
Total Culture and Recreation	4,835.00	4,835.00	5,030.35	(195.35)
Total Expenditures	107,202.00	107,202.00	75,528.89	31,673.11
Excess of Revenue Over (Under)				
Expenditures	(24,753.00)	(24,753.00)	24,192.01	48,945.01
Other Financing Sources (Uses):				
Compensation for Loss or				
Damage to Capital Assets	0.00	0.00	816.00	816.00
Net Change in Fund Balances	(24,753.00)	(24,753.00)	25,008.01	49,761.01
Fund Balance - Beginning	238,748.80	238,748.80	238,748.80	0.00
FUND BALANCE - ENDING	213,995.80	213,995.80	263,756.81	49,761.01

REQUIRED SUPPLEMENTARY INFORMATION
MUNICIPALITY OF SPENCER
BUDGETARY COMPARISON SCHEDULE
WELCOME TO SPENCER FUND
For the Year Ended December 31, 2005

	Budgeted Amounts		Actual Amounts	Variance with
	Original	Final	(Budgetary Basis)	Final Budget - Positive (Negative)
Revenues	0.00	0.00	0.00	0.00
Expenditures:				
Conservation and Development:				
Economic Development and Assistance				
(Industrial Development)	0.00	0.00	396.76	(396.76)
Total Expenditures	0.00	0.00	396.76	(396.76)
Net Change in Fund Balances	0.00	0.00	(396.76)	(396.76)
Fund Balance - Beginning	601.40	601.40	601.40	0.00
FUND BALANCE - ENDING	601.40	601.40	204.64	(396.76)

NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION

Schedules of Budgetary Comparisons for the General Fund
and for each major Special Revenue Fund with a legally required budget.

Note 1. Budgets and Budgetary Accounting:

The Municipality followed these procedures in establishing the budgetary data reflected in the financial statements:

1. At the first regular board meeting in September of each year or within ten days thereafter, the Governing Board introduces the annual appropriation ordinance for the ensuing fiscal year.
2. After adoption by the Governing Board, the operating budget is legally binding and actual expenditures for each purpose cannot exceed the amounts budgeted, except as indicated in number 4.
3. A line item for contingencies may be included in the annual budget. Such a line item may not exceed 5 percent of the total municipal budget and may be transferred by resolution of the Governing Board to any other budget category that is deemed insufficient during the year.
4. If it is determined during the year that sufficient amounts have not been budgeted, state statute allows the adoption of supplemental budgets.
5. Unexpected appropriations lapse at year end unless encumbered by resolution of the Governing Board.

Encumbrance accounting, under which purchase orders, contracts, and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the General Fund.

The Municipality did not encumber any amounts at December 31, 2005.

6. Formal budgetary integration is employed as a management control device during the year for the General Fund and special revenue funds.
7. Budgets for the General Fund and special revenue funds are adopted on a basis consistent with the modified cash basis of accounting.

NOTE 2. GAAP/Budgetary Accounting Basis Differences

The Municipality's budgetary process accounts for certain transactions on a basis other than GAAP. The major differences between the budgetary basis and the GAAP basis lie in the manner in which revenues and expenditures are recorded. Under the budgetary basis, revenue and expenditures are recognized on a modified cash basis. Utilizing the modified cash basis, revenues are recorded when received in cash and expenditures are recorded when paid. Under the GAAP basis, revenues and expenditures are recorded on the modified accrual basis of accounting on the governmental fund statements and on the full accrual basis on the government-wide statements.

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